B4750-1 2/4/83

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research & Planning Division

Friday (Noon) Feb. 4, 1983

The recent statements of Mr. Volcker, Mr. Reagan, and Mr. Regan were very well received in the U.S. and in Europe, although there appears to be little change in the content of their messages. The conciliatory attitude between the Administration and the Fed seems to have been responsible for the change in mood--particularly Chairman Volcker's statement that economic growth must be achieved, and President Reagan's statement that the Fed must be allowed flexibility on money supply growth. Yet the Fed continues to be "worried" about inflation and stubborn at the current level of interest rates. Need rates move lower? What if they turn higher? Let's examine some of the consequences of these alternatives in more precise quantitative terms.

The current level of interest rates is high by historic comparison but low by recent experience. Inflation is low by recent experience but high by historic standards. Taking a reasonable 5% forecast for inflation, expected inflation-adjusted interest costs are 5% for the coming year--high by historic standards. This is also high in comparison with our important Western European trade partners, particularly West Germany where a 2½% inflation-adjusted rate applies. While strict international comparisons of interest-cost burdens are hard to achieve, the U.S. would appear to have room to move rates down. But this would probably weaken the dollar, refueling inflation.

A weaker dollar would bring inflation up but not discernibly, partly because the U.S. still benefits from past dollar strength. Since end-1979, the dollar has risen about 35% on a weighted average basis. Statistical evidence indicates that this appreciation tends to lower the price level in the U.S. by 8%. With lags of two to three years on the pass-through to domestic prices, we have yet to experience some of the recent gains; if the dollar weakens, we simply lose some of the gains that would otherwise be in the pipeline (perhaps 2%-3%).

The debt situation in the developing countries is another reason for interest rates to come down, and this problem seems to have occupied much of Chairman Volcker's time of late. According to the IMF's own estimates, a one percentage point rise in short-term interest rates increases nonoil-producing LDCs' annual interest payments by about $2 billion (about 1/2% of goods and services exports). For countries that have already compressed imports and pressed lenders for additional financing, this is a considerable sum. Moreover, to the extent lower interest rates stimulate growth in the developed countries, the LDCs benefit, particularly those which export manufactures--and these are the most indebted. The IMF calculates this group grows three-quarters of one percentage point for each one percentage point of real growth in the industrialized countries. In this environment growth would be export led.

It is hard to believe that these factors could be put aside because of excessive growth in an innovation-afflicted monetary aggregate. The inflation rate continues downward. The economy recovers because rates are lower, particularly because of low auto financing rates. Inflation needs to be fought but only with continued "rearguard" action. Domestic and world economic growth still requires rates to continue on a downward trend, even though we may experience modest backups from time to time.

Robert A. Brusca

Irving Trust

Market Yields

	2/4/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	16.50%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.38	8.25	15.25
Repurchase Agreements	8.38	8.25	14.88
U.S. Treasury Issues			
Bills			
3 months	8.50	8.31	14.47
6 months	8.84	8.55	15.00
1 year	9.09	8.87	14.85
Coupons			
2 years	9.80	9.48	15.00
4 years	10.27	10.02	14.83
7 years	10.84	10.59	14.78
10 years	10.99	10.66	14.74
Long Bond	11.10	10.82	14.52
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.45	8.30	15.10
3 months	8.70	8.50	15.30
6 months	9.00	8.80	15.40
1 year	9.40	9.00	15.40
Banker's Acceptances			
1 month	8.50	8.35	15.10
3 months	8.70	8.50	15.35
6 months	9.00	8.85	15.45
Eurodollar Deposits			
1 month	9.00	9.00	15.63
2 months	9.19	9.13	15.75
3 months	9.31	9.25	15.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.50	8.25	15.00
1 month	8.50	8.25	15.00
3 months	8.38	8.25	14.25
Bank Holding Companies			
1 month	8.00	8.00	14.38
Dealer Placed:			
3 months	8.43	8.26	14.88
New AA Corporate Utility Bond	12.60	12.65	17.00
Tax Exempt			
6 month Project Notes	4.50	4.50	7.40
1 year AAA Bond	5.00	5.25	7.65
5 year AAA Bond	6.25	6.30	9.00
20 year AAA Bond	8.80	8.80	12.30

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629